

Legislative Audit Division

State of Montana



Report to the Legislature

May 2003

Financial Audit

For the Fiscal Year Ended June 30, 2002

Montana Water Pollution Control and Drinking Water State Revolving Fund Programs

Department of Environmental Quality
Department of Natural Resources and Conservation

We performed a financial audit of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs for the fiscal year ended June 30, 2002. This report contains the audited financial statements and accompanying notes for fiscal year 2001-02. We issued an unqualified opinion on the financial statements. The opinion means the reader may rely on the financial statement information presented.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2003, will be issued by March 31, 2004. The Single Audit Report for the two fiscal years ended June 30, 2001, was issued on March 26, 2002. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
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Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

May 2003

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the fiscal year 2001-02 financial audit of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) Programs. The Department of Natural Resources and Conservation requested the audit of these programs because annual audits are required by the federal Environmental Protection Agency.

The objectives of a financial audit include determining if the programs' financial statements present fairly their financial position at June 30, 2002, and the results of the programs' operations for the fiscal year then ended. We tested compliance with state and federal laws that have a direct and material impact on the financial statements.

The WPCSRF program provides loans at a reduced interest rate to finance construction of publicly-owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Water Pollution control loans are comprised of federal grants and state match funds, and must be repaid within 20 years. As of June 30, 2002, the Water Pollution Control Program had \$69,653,600 of outstanding loans.

The DWSRF provides low interest loans to communities for the construction of drinking water treatment facilities. Drinking water loans are comprised of federal grants and state match funds, and may be financed up to 30 years. At June 30, 2002, the Drinking Water Program had \$40,591,741 of outstanding loans.

On page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion which means the reader can rely on the presented information. The programs' financial statements begin on page A-3. Our opinion on the programs' supplementary financial information is on page B-1. The supplementary information begins on page B-3. Beginning on page C-1 is our report on compliance and internal control which is required by *Government Auditing Standards* issued by the Comptroller General of the United States. The departments have reviewed this report and agree with the contents.

We thank the directors of the Department of Environmental Quality and the Department of Natural Resources and Conservation and their staff for cooperation and assistance during the audit.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Department of Environmental Quality

Jan Sensibaugh, Director

Tom Livers, Deputy Director

Ann Danzer, Chief Financial Officer, Financial Services

Department of Natural Resources and Conservation

Bud Clinch, Director

Anna Miller, Financial Advisor

Ann Bauchman, Administrator, Centralized Services Division

For additional information concerning the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs, contact Anna Miller, Financial Advisor, at:

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The audit staff involved in this audit were Alexa O'Dell and Jeff Tamblyn.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
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INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Combined Balance Sheet of the Montana Water Pollution Control State Revolving Fund (WPCSRF) and Drinking Water State Revolving Fund (DWSRF) as of June 30, 2002 and the related Combined Statement of Revenues, Expenditures, and Changes in Fund Balance for the fiscal year then ended. The information contained in these financial statements is the responsibility of the management at the Montana Department of Environmental Quality and the Montana Department of Natural Resources and Conservation. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in the notes to the financial statements, the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs are intended to present the financial position and results of operations of only that portion of the financial reporting entity of the State of Montana that is attributable to the transactions of the programs.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of June 30, 2002, and its results of operations for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of the Legislative Audit Committee, department management, the Montana State Legislature, and the U.S. Environmental Protection Agency and is not

intended to be, and should not be, used by anyone other than these specified parties. This report is a matter of public record and its distribution is not limited.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 28, 2003, on our consideration of the Departments' (Department of Environmental Quality and Department of Natural Resources and Conservation) compliance with laws and regulations and the Department's internal control structure.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

March 28, 2003

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED BALANCE SHEET
SPECIAL REVENUE AND DEBT SERVICE FUNDS
JUNE 30, 2002**

	<u>WATER POLLUTION CONTROL</u>		<u>DRINKING WATER</u>		<u>TOTAL</u>
	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	
ASSETS					
Cash/Cash Equivalents	\$6,329,495	\$194,872	\$1,276,909	\$123,062	\$7,924,338
Due From Other Accounting Entities	62		80,373		80,435
Expense Advances to Employees	500		1,000		1,500
Accounts Receivable	20				20
Interest Receivable - Current	169,994	753,091	86,731	368,748	1,378,564
Interest Receivable - Long-Term	5,985,202	25,668,349	3,652,703	15,061,244	50,367,498
Investments	11,203,709	1,954,126	4,773,185	1,228,379	19,159,399
Loans Receivable - Current	3,742,538		1,570,117		5,312,655
Loans Receivable - Long-Term	65,911,062		39,021,624		104,932,686
Total Assets	<u>\$93,342,582</u>	<u>\$28,570,438</u>	<u>\$50,462,642</u>	<u>\$16,781,433</u>	<u>\$189,157,095</u>
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts Payable	\$31,720		\$226,158		\$257,878
Due to Other Accounting Entities	183		7,100		7,283
Vouchers Payable	37		15,087		15,124
Interentity Loans Payable	44,017		130,000		174,017
Arbitrage Taxes Payable		145,381		12,074	157,455
General Obligation Bonds Payable - Current		415,000		310,000	725,000
General Obligation Bonds Payable - Long-Term		12,700,000		8,620,000	21,320,000
Total Liabilities	<u>\$75,957</u>	<u>\$13,260,381</u>	<u>\$378,345</u>	<u>\$8,942,074</u>	<u>\$22,656,757</u>
Fund Balances					
Reserved for Loans Receivable	\$69,653,600		\$40,591,741		\$110,245,341
Unreserved, Undesignated	23,613,025	15,310,057	9,492,556	7,839,359	\$56,254,997
Total Fund Balances	<u>\$93,266,625</u>	<u>\$15,310,057</u>	<u>\$50,084,297</u>	<u>\$7,839,359</u>	<u>\$166,500,338</u>
Total Liabilities and Fund Balances	<u>\$93,342,582</u>	<u>\$28,570,438</u>	<u>\$50,462,642</u>	<u>\$16,781,433</u>	<u>\$189,157,095</u>

The accompanying notes to the financial statements are an integral part of this statement.

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
STATE REVOLVING FUND PROGRAMS
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
SPECIAL REVENUE AND DEBT SERVICE FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	<u>WATER POLLUTION CONTROL</u>		<u>DRINKING WATER</u>		<u>TOTAL</u>
	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	<u>SPECIAL REVENUE</u>	<u>DEBT SERVICE</u>	
REVENUES:					
Federal Capitalization Grant Revenue	\$11,494,689		\$10,570,781		\$22,065,470
Interest Income on Investments	861,384	177,965	(52,076)	314,816	1,302,089
Interest Earnings from Loans	723,166	1,821,779	438,032	885,156	3,868,133
Administration and Origination Fees	382,365		110,720		493,085
TOTAL REVENUES	\$13,461,604	\$1,999,744	\$11,067,457	\$1,199,972	\$27,728,777
EXPENDITURES:					
Program Administration/Set-Asides	\$428,942		\$1,106,591		\$1,535,533
TOTAL EXPENDITURES	\$428,942		\$1,106,591		\$1,535,533
Excess Revenues Over/(Under)	\$13,032,662	\$1,999,744	\$9,960,866	\$1,199,972	\$26,193,244
OTHER FINANCING SOURCES:					
Bonds Proceeds Adjustment			\$1		\$1
Bonds Cost of Issuance Adjustment	\$18,283		3,556		21,839
<i>Operating Transfers In:</i>					
Origination/Administrative Fees Transfer		256,102	40,420	70,300	366,822
Loan Loss Reserve Sweep	741,802		145,660		887,462
Investment Account Transfer		1,815,701			1,815,701
Arbitrage Rebates		100,612		23,206	123,818
Total Other Financing Sources	\$760,085	\$2,172,415	\$189,637	\$93,506	\$3,215,643
OTHER FINANCING USES:					
Bond Principal		\$2,385,000		\$205,000	\$2,590,000
Bond Interest		686,834		362,736	1,049,570
<i>Operating Transfers Out:</i>					
Origination/Administrative Fees Transfer	256,102		110,720		366,822
Arbitrage Rebates	100,612		23,206		123,818
Investment Account Transfer	1,815,701				1,815,701
Loan Loss Reserve Sweep		741,802		145,660	887,462
Total Other Financing Uses	\$2,172,415	\$3,813,636	\$133,926	\$713,396	\$6,833,373
Excess(deficiency) of revenues and other financing sources over/(under) expenditures and other financing uses	\$11,620,332	\$358,523	\$10,016,577	\$580,082	\$22,575,514
Fund Balance - July 1, 2001	\$75,661,091	\$2,543,566	\$36,415,017	\$1,140,106	\$115,759,780
GASB 34 Adjustment Interest Receivable Long-Ter	5,985,202	25,668,349	3,652,703	15,061,244	50,367,498
GASB 34 Adjustment Arbitrage Taxes Payable		(145,381)		(12,074)	(157,455)
GASB 34 Adjustment GO Bonds Payable		(13,115,000)		(8,930,000)	(22,045,000)
Fund Balance - June 30, 2002	\$93,266,625	\$15,310,057	\$50,084,297	\$7,839,358	\$166,500,337

The accompanying notes to the financial statements are an integral part of this statement.

**MONTANA STATE WATER POLLUTION CONTROL AND DRINKING
WATER STATE REVOLVING FUND PROGRAMS
SPECIAL REVENUE AND DEBT SERVICE FUND
NOTES TO FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

1. Organization of the Programs

The State of Montana's Water Pollution Control State Revolving Fund (WPCSRF) Program was established pursuant to Title VI of the Federal Water Quality Act of 1987. This federal act established the WPCSRF program to replace the construction grants program to provide a flexible financing source to loan money at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the WPCSRF provides for low interest rate loans to finance the entire cost of qualified projects.

The State of Montana's Drinking Water State Revolving Fund (DWSRF) Program was established pursuant to Title XIV of the Safe Drinking Water Act. This federal act established the DWSRF program for states to make loans to community water systems and nonprofit non-community water systems. Instead of making grants to communities that pay for a portion of building drinking water treatment facilities, the DWSRF provides for low interest rate loans to finance the entire cost of qualified projects or to refinance debt obligations on projects, which began after July 1, 1993. The State of Montana first incurred expenditures in the DWSRF Program in SFY1997.

WPCSRF loans must be repaid within 20 years, while DWSRF loan agreements allow up to 30 years for repayment. All repayments of interest and principal must remain in the Fund. Both programs are capitalized through U.S. Environmental Protection Agency (EPA) grants. States are required to provide an additional 20 percent of the federal capitalization grant as matching funds in order to receive a grant.

The programs are administered jointly by the Department of Environmental Quality (DEQ) Technical and Financial Assistance Bureau, and the Department of Natural Resources and Conservation (DNRC) Conservation and Resource Development Division. The Fund does not have any full time employees. Both funds are charged for time spent on SRF activities by department employees. The charges include salaries and benefits of the employees and operating expenses, as well as indirect costs.

2. Summary of Significant Accounting Policies

A. State Revolving Fund (SRF) Program Fund Structure

Both programs use Special Revenue and Debt Service Funds, as appropriate, to report their financial position and the results of operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions and activities. Montana maintains a State Special Revenue and a Federal Special Revenue Fund. The SRF programs are blended from a part of each Special Revenue

Fund. A fund is a separate accounting entity with a self-balancing set of accounts. Special Revenue and Debt Service Funds are considered governmental funds.

A Special Revenue Fund accounts for the proceeds of specific revenue sources restricted to expenditures for specified purposes (other than expendable trusts or major capital projects). A Debt Service Fund accounts for resources accumulated for payment of principal and interest on general long-term obligation debt.

B. Basis of Accounting

The accounting and reporting treatment applied to a fund is determined by its measurement focus. All governmental funds are accounted for on a current financial resources measurement focus. Only assets and current liabilities are generally included on their balance sheets. Governmental fund operating statements present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets.

These funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when received in cash unless susceptible to accrual. Revenues are susceptible to accrual if they are measurable and available within sixty days after the end of the fiscal year to finance expenditures of the fiscal year. Revenues are deferred if material and received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year-end. Expenditures are recognized when the related fund liability is incurred, with the following exceptions:

- 1) principal and interest on long-term debt are recognized when due;
- 2) prepayments are accounted for as expenditures in the period of acquisition;
- 3) inventory items are considered expenditures when purchased.

In FY 02, GASB 34 accounting procedures were implemented. GASB 34 accounting requires treatment of long-term assets and liabilities similar to proprietary fund full accrual accounting. This requires that all assets and liabilities, whether current or long-term, be reflected on the financial statements. Consequently, the FY 02 financial statements reflect a liability for the principal due on the SRF General Obligation Bonds. This obligation is split into two components, a current portion for the debt principal due within one year and a long-term portion for the debt due in a timeframe greater than one year. Corresponding long-term loan interest receivables were established in the Special Revenue and Debt Service funds in each program. Consequently, long-term interest receivables were established in the amount of \$50,367,498 and current and long-term bonds payable were established in the amount of \$22,045,000 in the Debt Service fund.

The Loans Receivable account resides in the State Special Revenue fund for each program. This account represents the principal due on the loans outstanding for each program. In compliance with GASB 34, the total loans receivable in each program were allocated between the current portion due within one year and the long-term portion due more than one year from the combined balance sheet date.

3. Cash/Cash Equivalents

Cash and cash equivalents consist of funds deposited with the Montana State Treasurer, and investments categorized as cash equivalents, which are short-term, highly liquid investments with original maturities of three months or less.

<u>Risk Category 1</u>	<u>Carrying Amount</u>	<u>Fair Value</u>	<u>Fund</u>
Money Market Direct Investment	\$3,932,688	\$3,932,688	Various

4. Investments

The Board of Examiners of the State of Montana authorizes the sale of general obligation bonds to provide the state match for the SRF programs through the issuance of an Indenture of Trust. The Board of Examiners is comprised of the Governor, Attorney General and the Secretary of State for the State of Montana. The Indenture of Trust specifies the eligible investments meeting defined rating and risk criteria in which the state may invest. The state invests funds through its trustee bank, US Bank, N.A.

<u>Security Type</u>	<u>Category 1</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Government Securities	\$22,509,823	\$22,509,823	\$22,890,853

5. Loans Receivable

Montana operates both SRF programs as direct loan programs. Loans made to communities through the Water Pollution Control Program are 83.33 percent funded by the federal capitalization grant, and 16.67 percent by the state match amount. Loans made by the Drinking Water Program are funded approximately 80 percent by the federal capitalization grant, and 20 percent by the state match amount. Loan funds are disbursed to the local agencies by the trustee bank as local agencies expend funds for the purposes of the loan and request reimbursement from the program. Interest is calculated from the date that funds are disbursed. Typically after the final disbursement has been made, the payment schedule is certified in the loan agreement and adjusted for the actual amounts disbursed. No provision for uncollectible accounts has been made as all loans are current in terms of compliance with the repayment schedules, and management believes that all loans will be repaid according to the terms of the loan agreement.

The drawn and outstanding principal balance of all closed loans guaranteed by the WPCSRF Program as of June 30, 2002, is \$69,653,600. The drawn and outstanding principal balance of all closed loans guaranteed by the DWSRF Program as of June 30, 2002, is \$40,591,741.

Loans mature at various intervals through July 1, 2023. The scheduled principal payments on loans maturing in the years after 2002 are as follows:

<u>Year ending June 30:</u>	<u>WPCSRF Amount</u>	<u>DWSRF Amount</u>
2003	\$ 7,652,848	\$ 1,889,300
2004	\$ 3,936,800	\$ 1,962,300
2005	\$ 4,176,800	\$ 1,877,400
2006	\$ 4,419,800	\$ 1,954,150
2007 and thereafter	\$ 49,467,352	\$ 32,908,591
Total	\$ 69,653,600	\$ 40,591,741

As of June 30, 2002, the WPCSRF and DWSRF had authorized loans to public entities of the State of Montana that in the aggregate exceeded \$118 and \$53 million, respectively. The outstanding balances of the largest loans in each portfolio are as follows.

Water Pollution Control State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Great Falls	\$ 12,100,000	\$ 1,109,247
City of Helena	\$ 9,320,000	\$ 8,992,810
Big Sky County Water & Sewer	\$ 5,513,000	\$ 4,092,000
City of Butte-Silver Bow	\$ 5,307,390	\$ 1,344,390
City of Missoula SID	\$ 4,577,000	\$ 287,860
City of Kalispell	\$ 3,913,000	\$ 2,517,000
Flathead County Evergreen	\$ 3,600,000	\$ 2,273,000
River Rock W&S District	\$ 3,100,000	\$ 3,090,000
City of Missoula SID	\$ 2,671,000	\$ 2,627,000
City of Columbia Falls	\$ 2,650,000	\$ 2,346,000
Total	\$ 52,751,390	\$ 28,679,307

Drinking Water State Revolving Fund:

<u>Local Agency</u>	<u>Authorized Loan Amount</u>	<u>Outstanding Balance</u>
City of Havre II	\$ 8,401,000	\$ 6,431,201
City of Whitefish II	\$ 5,839,000	\$ 5,227,000
City of Laurel	\$ 5,250,000	\$ 3,844,939
City of East Helena II	\$ 3,234,000	\$ 2,961,405
City of Great Falls	\$ 3,000,000	\$ 1,613,628
River Rock Water & Sewer	\$ 2,100,000	\$ 2,090,000
City of Glendive	\$ 1,829,000	\$ 1,529,000
Lockwood Water & Sewer	\$ 1,700,000	\$ 1,300,000
Ft. Peck Water & Sewer	\$ 1,520,000	\$ 1,410,617
Seeley Lake Water District	\$ 1,340,000	\$ 1,213,000
Total	\$ 34,213,000	\$ 27,620,790

6. Interest Receivable

The current portion of this account represents interest owed by borrowers as of June 30, 2002, for the July 1, 2002 payment. It represents the six months of interest accrued from the loan payment made in January, 2002. It does not include interest payments received in June that were due July, 2002. Interest payments received in June, 2002, amounted to \$296,517 for the WPCSRF and \$226,276 for the DWSRF.

The long-term interest receivable represents the total amount of interest due from borrowers on January 1, 2003, and in subsequent fiscal years. The interest due January 1, 2003, is classified as long-term because it was due more than six months from the end of the fiscal year.

7. Arbitrage Taxes Payable

The federal arbitrage taxes liability is attributable to cumulative net excess earnings on the general obligation bond proceeds and is calculated by Evensen Dodge, Inc., Financial and Investment Advisors. There is a 60-day requirement for tax return filing and payment for positive arbitrage rebate taxes. GASB 34 requires recognition and reporting of this liability that is attributable to a multiple year calculation.

8. Bonds Payable

General Obligation Debt-WPCSRF

Principal Payments

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range(%)</u>	<u>FY02</u>	<u>In Year of Maturity</u>	<u>Balance June 30, 2002</u>
1991B	\$ 2,595,000	5.00 - 6.80	\$1,965,000	Paid in Full (7/15/01)	\$ 0
1994B	\$ 2,200,000	4.20 - 6.10	\$ 80,000	\$ 180,000 (2016)	\$ 1,765,000
1996C	\$ 2,765,000	3.75 - 5.75	\$ 115,000	\$ 120,000 (2017)	\$ 2,285,000
1998A	\$ 3,510,000	3.75 - 5.15	\$ 125,000	\$ 260,000 (2019)	\$ 3,150,000
2000B	\$ 3,325,000	4.25 - 5.60	\$ 100,000	\$ 270,000 (2021)	\$ 3,225,000
2001H	\$ 2,690,000	4.00 - 5.00	\$ 0	\$ 200,000 (2021)	\$ 2,690,000
Total	\$ 17,085,000		\$2,385,000	\$ 1,030,000	\$13,115,000

Debt Service requirements (principal and interest) for WPCSRF are as follows:

<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>	<u>Totals</u>
\$901,110	\$911,726	\$915,755	\$908,500	\$905,055	\$10,063,258	\$14,605,404

General Obligation Debt-DWSRF

Principal Payments

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range(%)</u>	<u>FY02</u>	<u>In Year of Maturity</u>	<u>Balance June 30, 2002</u>
1998F	\$ 3,065,000	3.60 - 4.85	\$ 115,000	\$ 230,000 (2018)	\$ 2,840,000
2000A	\$ 2,990,000	4.25 - 5.60	\$ 90,000	\$ 240,000 (2021)	\$ 2,900,000
2001G	\$ 3,190,000	4.00 - 5.00	\$ 0	\$ 235,000 (2021)	\$ 3,190,000
Total	\$ 9,245,000		\$ 205,000	\$ 705,000	\$ 8,930,000

Debt Service requirements (principal and interest) for DWSRF are as follows:

<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>	<u>Totals</u>
\$721,823	\$733,593	\$729,458	\$724,728	\$729,205	\$10,427,799	\$14,066,606

Interest earnings from both programs have been and will be used to liquidate this long-term debt. The year of maturity refers to state fiscal year.

9. Fund Balance

A portion of the fund balance in the WPCSRF and DWSRF has been reserved for Loans Receivable, indicating that a portion of the fund balance is not available for expenditure.

The WPCSRF and DWSRF programs are capitalized by grants from the Environmental Protection Agency (EPA) and matching funds from the State of Montana. All grant funds drawn

are recorded as revenue. As of June 30, 2002, EPA has awarded capitalization grants of \$89,279,200 to the State of Montana for the WPCSRF program. \$71,756,814 has been drawn for loans and administrative expenses.. As of June 30, 2002, EPA has awarded capitalization grants of \$53,009,900 to the State of Montana for the DWSRF program. \$30,265,162 has been drawn for loans and administrative expenses. Montana has issued bonds totaling \$17,085,000 for use as state matching funds for the WPCSRF program and \$9,245,000 for use as state matching funds in the DWSRF program.

10. Federal Capitalization Grant Revenues

Actual draws of federal funds differ from the amount of Federal Capitalization Grant Revenue reported on the Statement of Revenues, Expenditures and Changes in Fund Balance. This occurs because state accounting policy requires federal special revenue funds reflect a zero fund balance at fiscal year-end (with the exception of "A" accruals). Consequently, if a positive fund balance exists, deferred revenue is recorded. If a negative fund balance is reflected at fiscal year-end, a revenue accrual to record revenue is recorded to zero the fund balance.

The following is a reconciliation of federal revenues reported on the financial statements to federal cash actually drawn during the state fiscal year:

WPC-SRF

Federal Capital Grant Revenue – Financial Statement:	\$11,494,689
Adjustment to Deferred Revenue from FY 01	372,222
Adjustment for FYE 02 Deferred Revenue	(320,952)
Adjustment to reconcile prior period revenue	<u>39,209</u>
Total Federal Draws	\$11,585,168

DW-SRF

Federal Capital Grant Revenue – Financial Statement:	\$10,570,780
Adjustment for Due From Federal Govt. - Prior Years	(225,657)
Adjustment to Deferred Revenue - Prior Years	851,404
Adjustment for FYE02 Deferred Revenue	(344,205)
Adjustment to reconcile prior period revenue	<u>14,304</u>
Total Federal Draws	\$10,866,626

11. Interest Income on Investments

This revenue represents interest earnings on investments in the various accounts within the Fund. All assets of the Fund are invested to the degree possible by the trustee in investment vehicles, ranging from cash equivalents to long-term investments.

12. Interest Earnings

This revenue represents interest earnings from loan repayments made by borrowers. A typical loan carries an interest rate of 4%. This 4% is comprised of a loan interest rate of 2.25%, as well as a 1.00% Loan Loss Reserve fee and a 0.75% Special Administration fee. The earnings for each of these components totaled \$1,484,978, \$575,007, and \$484,959, respectively, for the Water Pollution Control SRF program and \$764,300, \$303,894, and \$254,995, respectively, for the Drinking Water WRF program. Disadvantaged communities can receive loans with an interest rate of 3% because no Loan Loss Reserve fee is levied.

13. Program Administration

This expenditure represents costs incurred by DEQ and DNRC to administer the SRF programs. This amount is limited to 4% of each grant award from the EPA. Program Administration appears under the Resource Development/Recreation function in the State of Montana's CAFR.

14. Other Financing Sources and Uses

Loan interest amounts received that exceed the debt service requirements are shown as a Financing Source and Use on the financial statements. The balance remaining in the Debt Service Account is transferred to the Investment Account. Both accounts are within the SRF fund. This occurs after payments are rendered to the bondholders on July 15 of each year. In the Arbitrage Certificate, this activity is termed a Debt Service Sweep.

Administration and Origination Fees are shown as both a Financing Source and Use of funds because the fees are initially recorded inside the Loan Account when disbursed. These revenues are then transferred to the Special Administration and Loan Loss Reserve Accounts, which are outside the Fund.

RIT Transfers-In represents financial support provided to the programs utilizing state Resource Indemnity Trust (RIT) monies and considered in-kind match dollars for both programs.

The Loan Loss Reserve Sweep represents monies in excess of the reserve requirement that are transferred from the Loan Loss Reserve Account to the Special Administration Account per the bond indenture. Both accounts are considered outside the fund.

The Arbitrage Rebate Transfer reflects monies transferred into the Rebate Account (outside the fund) based on the annual arbitrage rebate liability calculation.

Recycled Fund transfers are transfers between the principal accounts in the WPCSRF and the DWSRF fund as allowed in Federal and State law as exercised by the Governor of the State.

15. Subsequent Events

An INTERCAP Bond Anticipation Note (BAN) for the Wastewater Program was issued by the Board of Investments in December, 2002, in the amount of \$2,000,000. The maturity date for the note is July 15, 2003. The note was issued in anticipation of the sale of a new bond during June, 2003. As of March 31 2003, four draws in the total amount of \$1,250,000 were requested and received by the department.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Our audit was conducted for the purpose of forming an opinion on the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements taken as a whole. The Schedule of Revolving and Non-Revolving SRF Program Assets, Special Revenue and Debt Service Funds, for the Montana Water Pollution Control and Drinking Water Programs and the related Schedule of Revolving and Non-Revolving SRF Program Revenues, Expenditures, and Changes in Fund Balance, Special Revenue and Debt Service Funds are presented for purposes of additional analysis and are not a required part of the financial statements of these programs. Such information has been subjected to the auditing procedures applied in the audit of the programs' financial statements and, in our opinion, based upon our audit, is fairly presented in all material respects in relation to the programs' financial statements taken as a whole.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

March 28, 2003

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM ASSETS
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
JUNE 30, 2002**

	WPC-SRF SPECIAL REVENUE		WPC-SRF DEBT SERVICE FUND		Drinking Water SPECIAL REVENUE		Drinking Water DEBT SERVICE FUND		TOTAL
	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	REVOLVING FUND	NON REVOLVING FUND	
ASSETS									
Cash/Cash Equivalents	\$2,422,975		\$3,906,520	\$8,053	\$1,226,362		\$62,682	\$60,379	7,924,336
Due From Other Accounting Entities	62				80,373				80,435
Advances to Employees	500				1,000				1,500
Accounts Receivable	20								20
Interest Receivable - Current	(270)		170,264	528,582		86,731	260,195	108,553	1,378,584
Interest Receivable - Long-Term			5,985,202	17,955,605		3,652,703	10,957,685	4,103,559	50,367,498
Investments	11,133,446		70,264	529,949	4,027,431	745,754	474,228	754,150	19,159,399
Loans Receivable - Current	3,742,538				1,570,117				5,312,655
Loans Receivable - Long-Term	65,911,062				39,021,624				104,932,686
Total Assets	\$83,210,333	\$10,132,250	\$19,022,189	\$9,548,249	\$45,926,907	\$4,535,735	\$11,754,791	\$5,026,641	\$189,157,095
LIABILITIES AND FUND BALANCES									
Liabilities:									
Accounts Payable	31,720				226,158				257,878
Due to Other Accounting Entities	183				7,100				7,283
Vouchers Payable	37				15,087				15,124
Interentity Loans Payable	44,017				130,000				174,017
Arbitrage Taxes Payable								12,074	157,455
General Obligation Bonds Payable-Current				415,000			310,000		725,000
General Obligation Bonds Payable-Long-Term			12,700,000				8,620,000		21,320,000
Total Liabilities	\$75,957		\$13,115,000	\$145,381	\$378,345		\$8,930,000	\$12,074	\$22,656,757
Fund Balances									
Reserved for Loans Receivable	\$69,653,600				\$40,591,741				110,245,341
Unreserved, Undesignated	13,480,776		10,132,250	5,907,189	4,956,821		4,535,735	2,824,791	56,254,997
Total Fund Balances	\$83,134,376		\$10,132,250	\$5,907,189	\$45,548,562		\$4,535,735	\$5,014,567	\$166,500,338
Total Liabilities and Fund Balances	\$83,210,333	\$10,132,250	\$19,022,189	\$9,548,249	\$45,926,907	\$4,535,735	\$11,754,791	\$5,026,641	\$189,157,095

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated revolving fund (within the fund) and non-revolving fund (outside the fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the revolving fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination

(1) Generally Accepted Accounting Principles (GAAP).

**MONTANA WATER POLLUTION CONTROL AND DRINKING WATER
SCHEDULE OF REVOLVING AND NON-REVOLVING SRF PROGRAM
REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
SPECIAL REVENUE AND DEBT SERVICE FUNDS
REGULATORY BASIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2002**

	WPC-SRF SPECIAL REVENUE REVOLVING FUND	WPC-SRF DEBT SERVICE FUND REVOLVING FUND	WPC-SRF NON REVOLVING FUND	Drinking Water SPECIAL REVENUE REVOLVING FUND	Drinking Water DEBT SERVICE FUND REVOLVING FUND	Drinking Water NON REVOLVING FUND	TOTAL
REVENUES:							
Federal Capitalization Grant Revenue	\$11,494,689			\$10,570,780			\$22,065,469
Interest Income on Investments	676,899	184,485	53,696	(94,167)	300,666	\$14,150	1,302,089
Interest Earnings from Loans	296,517	426,649	1,303,625	226,276	634,585	\$250,571	3,868,134
Administration and Origination Fees	382,365			110,720			493,085
Total Revenues	\$12,850,470	\$611,134	\$1,427,894	\$10,813,609	\$935,251	\$264,721	\$27,728,777
EXPENDITURES:							
Program Administration/Set-Asides	\$428,942			\$1,106,591			\$1,535,533
Total Expenditures	\$428,942			\$1,106,591			\$1,535,533
Excess Revenues Over/(Under) Expenditures	\$12,421,528	\$611,134	\$1,427,894	\$9,707,018	\$935,251	\$264,721	\$26,193,244
OTHER FINANCING SOURCES:							
Bond Proceeds Adjustment		\$18,283			\$1	\$1	\$1
Operating Transfers In:					3,556		21,839
Recycled Fund Transfers				93,114			93,114
Administration and Origination Fees		147,257	256,102		40,420	70,300	514,079
Arbitrage Rebates			100,612			23,206	123,818
Investment Account Transfer		1,815,701					1,815,701
Loan Loss Reserve Sweep	741,802			145,660			887,462
Total Other Financing Sources	\$741,802	\$165,540	\$1,815,701	\$238,774	\$43,977	\$93,506	\$3,456,014
OTHER FINANCING USES:							
Bond Principal							
Bond Interest		\$2,385,000			\$205,000		\$2,590,000
Operating Transfers Out:		686,834			362,736		1,049,570
Recycled Transfers						93,114	93,114
Administration and Origination Fees	403,359			110,720		514,079	1,028,158
Arbitrage Rebates	100,612			18,442		123,818	242,872
Investment Account Transfer	1,815,701				4,764	1,815,701	3,635,206
Loan Loss Reserve Sweep			741,802				741,802
Total Other Financing Uses	\$2,319,672	\$3,071,834	\$741,802	\$129,162	\$587,736	\$145,660	\$7,073,745
Excess(deficiency) of revenues and other financing sources over/(under) expenditures and other financing uses	\$10,843,658	\$776,674	\$171,761	\$9,816,630	\$189,947	\$212,567	\$22,575,514
Fund Balance - July 1, 2001	\$72,290,718	\$3,370,373	\$894,824	\$1,648,742	\$3,817,920	\$710,125	\$115,759,780
Redeemability July 1 Fund Balance: Bond Proceeds				\$32,597,097	\$3,817,920	\$429,981	\$115,759,780
GASB 34 Adjustment Interest Receivable Long-Term		5,965,202	17,955,605	\$3,134,835	(\$3,134,835)		50,387,498
GASB 34 Adjustment Arbitrage Taxes Payable			7,712,744	3,652,703	10,957,885	4,103,559	(157,455)
GASB 34 Adjustment GO Bonds Payable			(13,115,000)	(145,361)	(8,930,000)	(12,074)	(22,045,000)
Fund Balance - June 30, 2002	\$83,134,376	\$10,132,249	\$9,402,867	\$45,548,562	\$4,535,735	\$5,014,177	\$166,500,336

This schedule is prepared on a regulatory basis of presentation, rather than a GAAP (1) basis, as requested by the Environmental Protection Agency (EPA) for the Water Pollution Control and Drinking Water State Revolving Fund (SRF) Programs. This presentation separates certain regulated revolving fund (within the fund) and non-revolving fund (outside the fund) activity by fund type. All proceeds from the EPA Capitalization Grant, corresponding state matching funds, and loan principal and interest repayments must be deposited into the revolving fund under Title VI of the Clean Water Act and Title XIV of the Safe Drinking Water Act. Other proceeds, including Administration and Origination Fees and Loan Loss Reserves are deposited into the Non-Revolving Fund and may be used for other water quality purposes under the federal acts mentioned above.

(1) Generally Accepted Accounting Principles (GAAP).

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
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James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Legislative Audit Committee
of the Montana State Legislature:

We have audited the financial statements of the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs as of and for the fiscal year ended June 30, 2002, and have issued our report thereon dated March 28, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Montana Water Pollution Control and Drinking Water State Revolving Fund Programs' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Departments' (Department of Environmental Quality and Department of Natural Resources and Conservation) internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be a material weakness. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of

performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Legislative Audit Committee, department management, the Montana State Legislature, and the U.S. Environmental Protection Agency and is not intended to be, and should not be, used by anyone other than these specified parties. This report is a matter of public record and its distribution is not limited.

Respectfully submitted,

(Signature on File)

James Gillett, CPA
Deputy Legislative Auditor

March 28, 2003